

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

Appeal No.

75-7483

IN THE
United States Court of Appeals
FOR THE SECOND CIRCUIT

WALLACE CLARK & CO., INC.,
Plaintiff-Appellant,
v.
ACHESON INDUSTRIES, INC.,
Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLEE

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WALLACE CLARK & CO., INC.

Plaintiff-Appellant

v.

Appeal No. 75-7483

ACHESON INDUSTRIES, INC.

Defendant-Appellee

BRIEF FOR APPELLEE

STATEMENT OF THE CASE

The litigation concerning the patent in suit, H. J. Dawe et al No. 2,976,257 (owned by defendant-appellee Acheson Industries, Inc.) was first initiated in December, 1971 when Wallace Clark & Co., Inc. (plaintiff-appellant herein) filed a declaratory judgment action in the Southern District of New York (Civil Action No. 71-5655) seeking to have the patent declared invalid. After significant pretrial discovery was made in the first civil action the parties eventually arrived at a settlement whereby Wallace Clark and Acheson executed a non-exclusive license agreement (A 7-14); and, the prior civil action was concluded on October 6, 1972 with the entry of a consent decree (A 14-16)* holding

*Appellant's Appendix has mistakenly put the three pages of the prior consent decree out of order --- the first page of the decree is pg. A15, the second page of the decree is pg. A16, and the third page of the decree is pg. A14.

the patent both valid and infringed by Wallace Clark's product Meta-Tef 530. A back royalty payment in the amount of \$3375.00 (A 11) was paid by Wallace Clark to Acheson at the time of settlement, and royalty payments after that time were made up through January 1, 1974.

Thereafter Acheson learned that Wallace Clark was still manufacturing and selling products falling within the patent. Thus in April, 1974, Acheson filed suit in the Michigan state court for breach of the license agreement (A 17) and Wallace Clark filed a Michigan counterclaim alleging invalidity and non-infringement.

In June, 1974 Wallace Clark filed in the Southern District of New York a countersuit to the Michigan action, with this suit in the district court below framing the same issues as presented in the Michigan case (A 1, 23 & 26). By stipulation the Michigan case was subsequently dismissed without prejudice to either party (A 67) and, Judge Weinfeld then proceeded to render his opinion (A 39) of April 28, 1975 holding that the earlier consent decree was binding as to the validity of the patent and its infringement by Wallace Clark's 530 product. Wallace Clark next requested reconsideration or leave to appeal. Judge Weinfeld's second opinion (A 51) of July 21, 1975: (1) reaffirmed that the prior consent decree between the parties was res judicata as to patent validity and infringement by the Meta-Tef 530 product, but that this did not foreclose Wallace Clark from asserting at trial non-infringement by modified products not referred to in the prior consent decree,

(2) directed entry of judgment in Acheson's favor pursuant to Rule 54(b) F.R.C.P. as to the third count of Wallace Clark's complaint which challenged the validity of the patent, thus certifying the res judicata holding for appeal, (3) granted Wallace Clark's motion to dismiss Acheson's second counterclaim for contempt in that the prior decree did not include an injunction, and (4) denied Wallace Clark's motion for summary judgment upon its second cause of action for patent misuse.

Thus Wallace Clark has brought this appeal in an attempt to overrule the district court's decision that the prior consent decree between the same parties is res judicata as to the validity of the patent and its infringement by the Meta-Tef 530 product.

ARGUMENT

I. The Prior Consent Decree Holding Both Validity And Infringement Is Res Judicata

Wallace Clark has placed substantial emphasis for its appeal on the Supreme Court decision in Lear, Inc. v. Adkins 395 U.S. 653 (1969). The Lear decision only held that the doctrine of licensee estoppel should be abolished and that a licensee should be permitted to contest the validity a licensed patent notwithstanding the presence of a license agreement. No prior consent decree of any sort was present in Lear and there is no holding in Lear that once a patent

has been held valid and infringed in earlier litigation between the same parties, that this should not be binding as res judicata. To construe in any other fashion, as erroneously urged by Wallace Clark, would lead to a host of problems. For example, if Wallace Clark's position were accepted it would mean that all patent infringement suits would have to be fully litigated through the normally extensive pretrial discovery and a full trial on the merits, for it would not be possible to have a binding pretrial settlement by consent decree. This would lead to a special type of civil action incapable under any circumstances of being settled without a full trial on the merits. This would cause a further straining of already crowded court calendars and would directly contravene the strong public policy favoring judicial economy and settlement of litigation whenever possible. It would mean that the accused infringer would not be limited to "...having his day in court," rather he could secure under Wallace Clark's theory the right to repetitive litigation on the same issues. Moreover the district court was fully aware of Lear and perceptively pointed out why the rationale of Lear did not apply to the present case (A 42-45).

A. The Case Law and Public Interest Both Support a Finding of Res Judicata.

Wallace Clark has also placed heavy reliance for its position on decisions from the Seventh Judicial Circuit, such as Kraly

v. National Distillers and Chemical Corp., 502 F. 2d 1366 (7th Cir., 1974). However, Kraly is factually distinguishable because the earlier consent decree therein held patent validity only and did not find infringement. The importance of this distinction has been emphasized by this Court in Addressograph-Multigraph Corp. v. Cooper, 156 F. 2d 483 (2nd Cir., 1946) and Broadview Chemical Corp. v. Loctite Corp., 474 F. 2d 1391 (2nd Cir., 1973).

Moreover, Wallace Clark's erroneous reliance on Kraly and earlier Seventh Circuit decisions has been laid to rest in the recent decision USM Corp. v. Standard Pressed Steel Co., _____ F. 2d _____, (7th Cir., 10/22/75, No. 74-1938) which specifically states:

"the question...whether a consent judgment adjudicating infringement as well as [emphasis added] validity bars a party to the judgment from subsequently challenging the validity of the patent, has not been decided by this court (see Kraly v. National Distillers & Chemical Corp., 502 F. 2d 1366, 1368-1369 (7th Cir., 1974)." *supra* pg. 3

The USM decision involved an interlocutory appeal in a declaratory judgment action brought by the licensee USM to have the patent declared invalid. The licensee sought to prevent the licensor from collecting royalties that would accrue during pendency of the litigation should the patent eventually be held invalid and the licensee moved for a preliminary injunction against termination of the license by the licensor. The Seventh Circuit held that the preliminary injunction should be denied on the basis that if it should ultimately be decided "that the consent judgment is

res judicata or that the patent is valid, it will be unnecessary to decide the question of entitlement of royalties..." supra pg. 5.

Thus it is clear from the above that the Seventh Circuit has not yet ruled on the main question presented in this appeal. That is, does the prior consent decree between the parties holding the patent valid and infringed by the Meta-Tef 530 product prevent Wallace Clark from again contesting the validity of the patent in the pending district court action involving the modified forms of accused infringing products sold by Wallace Clark.

The case law in this area has been developed in several of the Judicial Circuits, namely the Second, Sixth, Eighth, and Ninth Circuits have all rendered decisions directly in point.

The Second Circuit was apparently the first to examine and formulate this area of the law in its 1946 Addressograph and 1973 Broadview decisions. The law of these decisions is stated in Broadview, 474 F. 2d., at 1394-95:

"We finally are faced with the Consent Decree of February 15, 1967 in which the parties to this appeal solemnly agreed that the patents in issue were valid and had been infringed. Does this decree estop Broadview from questioning the validity of the Loctite patents? This question has been decided in this Court in Addressograph-Multigraph Corp. v. Cooper, 156 F. 2d 483, 485 (2nd Cir., 1946), where we said:

[W]e think on grounds of public policy we ought to rule that in a decree at

least in one entered by consent, either an adjudication of infringement, or a grant of some relief from which infringement may be inferred, is essential before any effect of *res judicata* can be given to it on the issue of validity.

In that case there was no adjudication of infringement and no *res judicata* effect was given to the decree. Here of course infringement was adjudicated and the decree recited that Broadview had made a monetary payment for infringement.

Appellant urges that Addressograph is no longer good law in view of the holding of the Supreme Court in Lear, Inc. v. Adkins, 395 U.S. 653, 670-671, 89 S. Ct. 1902, 23 L.Ed. 2d 610 (1969), that a licensee is not estopped from questioning the validity of a patent which he recognized in the license agreement. Appellant cites no authority for this extension of *Lear* to the consent decree cases where there has been a prior adjudication of infringement."

The cases relied on in Wallace Clark's brief, pages 7-8, are clearly not in point because they involve situations where the prior decree did not adjudicate infringement and thus *res judicata* was not found, per the Addressograph-Broadview rule. Even the Seventh Circuit has now withdrawn from its *dicta* statements in Kraly to make special note in USM supra that the question has not yet been decided in the Seventh Circuit. We turn now to post Lear decisions from other Judicial Circuits.

The Sixth Circuit in Schlegel Mfg. Co. v. USM Corp. (No. 74-2256, 9/25/75) gave a detailed discussion of the matter now presented with respect to a prior consent decree that held the patent valid and infringed:

"On this appeal USM contends that the public policy interests discussed in *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969), renders a finding of invalidity more important than the policies of finality served by the doctrine of *res judicata*."

"The consent decree represents more than a mere agreement between the parties, or a stipulated dismissal. The District Court received the agreement, signed it and ordered it entered as a final judgment." supra, pg. 4

"Even though the degree of judicial involvement is different between a consent decree and a litigated result, we are not prepared to find that judicial involvement in a consent decree is so inconsequential as to justify different treatment."

"Looking to the rationale of *Lear*, we note that there is a significant difference between the effect of a consent decree and the doctrine of licensee estoppel. The parties to the patent suit are entitled to a full and fair hearing on the merits of the case up until the time a consent decree is entered. The doctrine of licensee estoppel closed the doors of the courts to a large group of parties who had sufficient interest in the patent to challenge its validity. By giving *res judicata* effect to consent decrees we do not close the doors of the courts to litigation on the issue of patent validity, except as to parties or their privies, and only after they have had the opportunity to litigate the issue fully." supra, pg. 9

"The public interest requires that an invalid patent be stripped of its monopoly, and at as early a date as possible. When a consent decree is to be given res judicata effect, litigants are encouraged to litigate the issue of validity rather than foreclosing themselves by a consent decree. If they were given a second chance to litigate the issue of validity, alleged infringers might well accept a license under a consent decree and forego an attack on validity until favored by a stronger financial position, or until threatened by other manufacturers who were not paying royalties. By giving res judicata effect to consent decrees this court protects the public interest in that an alleged infringer is deprived of a judicial device which could be used to postpone and delay a final adjudication of validity."

supra, pg. 10

Wallace Clark's public policy position in this case, we submit, is also plainly answered by the reasoning set forth in Judge Weinfeld's opinion (A 46):

"In this court's view, a balancing of the relevant public interest factors requires that consent decrees containing adjudications of validity and infringement, entered into without collusion, after the litigants have had the opportunity for pretrial discovery and a trial on the merits, be accorded res judicata effect. Such decrees should be of no less binding force than a judgment of validity and infringement entered after a trial on the merits. To hold otherwise would permit abuse of the judicial process, waste of judicial resources and reward questionable ethical conduct. These are all matters which also concern the public interest."

"To plaintiff's contention that it should again be permitted to challenge the validity of the patent in the public interest, the short answer is that it had that opportunity in its first declaratory judgment action wherein it consented to the decree it now seeks to void. Either it then failed to serve the public interest when it abandoned its attack on the validity of the patent or, perhaps satisfied it was valid, served its own economic interest. Having derived the benefits of a settlement and a license agreement, plaintiff should not now, upon a claim that it is the defender of the public interest, be permitted to disavow its commitments."

The Eighth Circuit in U.S. ex rel Shell Oil Co. v. Barco, 430 F. 2d 998, 1001-1002 (8th Cir., 1970), where a prior consent decree holding both validity and infringement was involved, has also specifically followed the law of Addressograph and Broadview, while noting that Lear is not controlling.

The Ninth Circuit as noted in Broadview, supra pg. 1395, has also held that a prior decree entered by default and finding both validity and infringement is res judicata in a subsequent declaratory judgment action between the same parties or their privies, Schnitger v. Canoga Elect. Corp., * 462 F. 2d 628 (9th Cir., 1972).

B. The Prior Decree is a Judicial Act and as Such is Binding Between the Parties.

Wallace Clark has argued that decisions such as Broadview and Schlegel are not pertinent because they dealt with contempt actions.

* See also the district court opinion statement concerning the applicability of the Schnitger decision at A47.

However, we submit that this is a meaningless distinction in that the prior consent decree is a judicial act in and of itself. Thus the form of the subsequent action [whether it be for patent infringement, breach of license contract, or contempt] does not change the nature and binding effect of the earlier judicial act, nor should any collateral attack against the binding nature of the prior decree be permitted on this ground. That a consent decree is a judicial act and not simply a contract matter is brought out in U.S. v. Swift & Co., 76 L. Ed. 999, 286 U.S. 106, 115, 119 (1932):

"The result is all one whether the decree has been entered after litigation or by consent."

"We reject the argument for the interveners that a decree entered upon consent is to be treated as a contract and not as a judicial act."

"They chose to renounce what they might otherwise have claimed, and the decree of a court confirmed the renunciation and placed it beyond recall."

Thus the fallacious reasoning in Wallace Clark's argument is exemplified as follows. If an injunction against any further infringement had been present in the prior consent decree here involved, then Wallace Clark would apparently consider cases such as Broadview, Schlegel and

Shell Oil to be fully controlling. However, since the earlier lawsuit was concluded with a license agreement rather than a permanent injunction against further infringement, by some strange analogy Wallace Clark now considers itself able to again contest validity whereas such would not be the case had they been permanently enjoined.

C. Adoption of Wallace Clark's Argument Would Create Fundamental Problems for the Judiciary.

Wallace Clark's position on this appeal clearly suggests that a decree of a court, honestly arrived at and genuinely given, should not be honored. This poses fundamental questions, not only as to the court's power to issue orders and to give effect to its orders once issued, but also poses the following additional queries:

1. Whether Rule 68 F.R.C.P. providing for entry of judgment upon an offer of judgment should be made inapplicable to patent cases?
2. Whether a patent case should be different from all other cases and be settleable only after a full trial on the merits?
3. Whether the Federal Courts, at both the trial level and the appellate level, should guarantee an increased work load from patent cases by in effect, requiring every patent case filed to be tried.

These are the ultimate questions which must be faced and resolved prior to any adoption of Wallace Clark's arguments. To make this adoption, we submit, would foster neither the judicial system nor the public interest.

D. The Paragraph 3 Language of the Prior Decree Does not Prevent it from Being Res Judicata.

Wallace Clark has also urged that the prior consent decree is not binding as res judicata because of the paragraph 3 language (A 15) in the decree that "...[t]his decree may not be cited as an adjudication of contested issues, nor be used for advertising purposes."

This argument was never made by Wallace Clark in the district court.

As pointed out in the district court's opinion (A 41, fn. 2)

"The provision of paragraph 3... is regularly included in patent consent decrees in this district, and this court has always required its inclusion. The provision was never intended to deprive consent decrees of their res judicata effect and plaintiff makes no such claim in this court. The clause was designed to prevent misuse of consent decrees with respect to third parties by representations, whether explicit or implicit, that the judgment was entered after a trial on the merits. See PCR Golf Ball Co. v. Chemold Corp. 361 F. Supp. 187 (EDNY, 1973). The same precautionary provision is included in copyright cases."

Moreover the paragraph 3 language cannot in any fair manner be considered as making the prior consent decree only a stipulated dismissal [as noted in the Michigan state court case (A 63)] because Federal Civil Procedure Rule 41 states that such a dismissal is without prejudice unless otherwise stated and it is manifestly clear that the prior consent decree involved here contains a specifically stated order of the district court which was highly prejudicial to Wallace Clark's position.

Namely the consent decree stated that the patent was both valid and infringed by Wallace Clark's product Meta-Tef 530, i.e., the product in issue at the time of the earlier lawsuit between the parties. It is of course settled law that no consent decree is binding against third parties or parties not privy to the decree. However, the prior consent decree in this case was between the very same parties now before this Court, and thus, the consent decree is clearly binding on Wallace Clark. Lastly, even were Wallace Clark to assert that the paragraph 3 language made the prior consent decree ambiguous in some way, the decree would still be binding as res judicata. Brunswick v. Chrysler Corp., 408 F. 2d 335 (7th Cir., 1969).

II. Consent Decree Res Judicata Is Fully Proper And Creates No Difficulty For Infringement Determination As To Modified Products.

In its brief at page 26 Wallace Clark has asserted that consent decree res judicata or estoppel is improper, and that if permitted, problems will arise concerning determination of infringement as to modified accused product(s) now sold by Wallace Clark. This argument is totally without merit as can be demonstrated by the following analogy. Firstly as the trial court recognized in its opinion. (A 48) and we agree, Wallace Clark will not be prevented from attempting to prove at the trial that its modified accused product(s) fall outside the scope of the patent claims and that therefore the modified products do not infringe, or fall within the scope of the patent license. This would be the case regardless of whether the earlier litigation between the parties had been concluded after a full trial on the merits holding the patent valid and infringed by the Meta-Tef 530 product, or by consent decree as actually occurred. As to the former Wallace Clark has never even remotely attempted to assert that an earlier holding of validity and infringement after trial on the merits would not be binding as res judicata. And were this the situation there would be no problem in the capability of the trial court to make a determination, after all facts are presented, as to whether the modified accused products constitute an infringement within the scope of the patent. However, only because the earlier decree was by consent, Wallace Clark now urges that the district court is not

capable of determining at the trial whether the modified products are covered by the scope of the patent claims. In point of fact we feel certain that the district court will conclude at the trial that the modified product does clearly fall within the scope of the patent claims, however the factual matters involved in this determination are not presented in the record before this court. A similar situation was referred to in General Electric Co. v. Hygrade Sylvania Corp., 61 F. Supp. 476 (S.D.N.Y., 1944) at page 491:

"In an earlier suit by plaintiff, General Electric Company, against defendant Hygrade Sylvania Corporation, for infringement of certain claims of Hull patent No. 1,790,153, defendant consented to the entry of a final decree (dated December 18, 1934) adjudging claim 3 and other claims of said patent valid and infringed 'by the defendant's manufacture and sale of electrical discharge devices utilizing the inventions of each of said claims.' Defendant's infringing device in that suit was a rectifier known as tube No. 872 A. As between the parties to this present suit that decree is conclusive on the issue of the validity of claim 3."

"However, that decree does not bar the defendant from offering proof in this case as to the state of the prior art, for the purpose of showing the scope of claim 3 of the Hull patent, on the issue of noninfringement."

Thus there is no problem in the capability of the district court to make this determination at the trial, notwithstanding any trumped up argument to the contrary by Wallace Clark.

It is clear that the prior consent decree was a judicial act made by the district court below and, Wallace Clark's counsel (A 36, paragraph 6, Mr. Blaustein's affidavit) on numerous occasions in the lower court argued their position to be that the prior decree was a matter of federal law and that the effect of the decree should be ruled on by the district court applying Second Circuit law. Now however Wallace Clark argues that validity of the patent has become a contract defense and, that it therefore becomes a contract issue to be governed only by state law. The cases cited in this regard by Wallace Clark are American Harley Corp. v. Irvin Industries, Inc., 27 N.Y. 2d 168 (N.Y. Ct. App. 1970), 167 USPQ 553; Research Frontiers, Inc. v. Marks Polarized Corp., 290 F. Supp. 725 (E.D.N.Y., 1968) and Wade v. Lauder, 165 U.S. 624 (1897); and Rialto Products, Inc. v. Rayex ____ NYS ____, 166 USPQ 222 (1970). However none of these cases support the proposition made by Wallace Clark, nor do any of these cases even deal with a situation where any type of a prior consent decree was involved. The prior consent decree is a judicial act in and of itself and must be given effect as such, it is not merely a contract, U.S. v. Swift & Co., supra, 286 U.S. at 115. Blonder-Tongue Lab. v. University Foundation, 402 U.S. 313 (1971), referred to by Wallace Clark does not require any different result. Blonder-Tongue is not applicable or controlling in this case because in Blonder-Tongue the Supreme Court only ruled that once a patent had been earlier held invalid in a fully litigated proceeding, that

the effect of such a holding would be to cause in rem invalidity as to other third parties subsequently sued by the patentee. There was no license agreement involved in Blonder-Tongue, nor was there any prior consent decree, particularly one which had held the patent valid and infringed as there is in the present case.

Wallace Clark's brief, page 20, has also relied on various numerical statistics concerning the outcome of patent infringement lawsuits over the years. While these statistics may or may not be accurate, one of the main articles from which these statistics are taken concludes that:

"The possession and assertion of patent rights are issues of great moment to the public, but the public interest expressed in Lear should not be read as mandating multiple challenges -- by the same parties -- to the validity of patents. Rather, the public interest demands a careful weighing of the competing policies. When parties have availed themselves of the courts' remedies, the entry of a formal, albeit consent, decree should be a conclusive determination of their rights, including the validity or invalidity of the patent at issue. To allow relitigation of those rights would subvert the public policy *res judicata* principles purport to subserve, and divert research and development funds to wasteful litigation and compound court congestion. Hopefully, as the Second Circuit urged in one case, patent litigants in the future will be able to return to their laboratories instead of their lawyers' offices." (citing Broadview) ["To Bind or Not to Bind - Bar and Merger Treatment of Consent Decrees in Patent Infringement Litigation," 74 Col.L.Rev. 1322, 1349-50 (Nov. 1974)]

III. There Is No Patent Misuse In This Case.

In certain portions of its brief (pg. 14) Wallace Clark has implied that Acheson has carried out a patent misuse due to certain provisions of the settlement license agreement between the parties (A 7-13). Wallace Clark has cited no cases in support of this position, and all of the pertinent factual matters concerning this allegation are not present in the record before this Court. Thus this matter is not even properly before the Court on this appeal. Moreover, the district court decision (A 56-59) held that there was no patent misuse of any kind and denied Wallace Clark's motion for summary judgment on this point. While all of the facts supporting the form of settlement license agreement finally arrived at between the parties at the conclusion of the earlier litigation are not in this record, the following assessment can be made. The settlement license agreement of September 1972 required a payment for back royalties in the amount of \$3375.00 which was paid upon execution of the agreement (A 11, para. 9). The agreement (A 8-9) contained a requirement of fixed yearly minimum royalties over the remaining life of the patent [which expires March 21, 1978] with this requirement totalling less than \$45,000.00. This manner of structuring the agreement was arrived at so that Wallace Clark could avoid the necessity of a large initial settlement payment for past damages or a large initial down payment for the license, while at the same time it gave consideration to

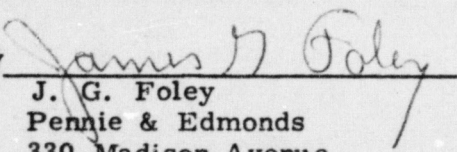
Acheson for permitting Wallace Clark's licensed entry into a patented proprietary business which had been commercially successful to Acheson over a long time period. In this connection it should be noted that Acheson could have refused to grant a license in any form, and could have proceeded with the earlier lawsuit to a conclusion and obtained a permanent injunction against Wallace Clark which would have prevented them from practicing the invention in any manner whatsoever.

CONCLUSION

The decision of the trial court holding that the prior consent decree is to be accorded res judicata effect with respect to the adjudication of (1) the validity of the patent, and (2) infringement of the patent by Wallace Clark's product Meta-Tef 530 should be affirmed.

Respectfully submitted,

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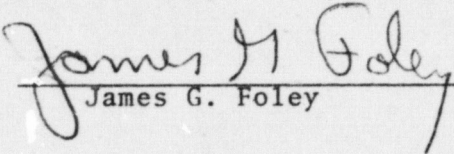
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CERTIFICATE OF SERVICE

I hereby certify that two copies of the BRIEF
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